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INTELLIGENCE HIGHLIGHTS NO. 20
WEEK OF 21 SEPTEMBER - 27 SEPTEMBER 1948

SECTION I. SUMMARY OF FAR EAST TRENDS AND DEVELOPMENTS

The extent of increased Soviet influence on Japan's trade is indicated by USSR desire to procure locomotives and rolling stock from Japan (page 3).

Recent events in China and Japan indicate renewed interest in a peace settlement (page 3).

The recent Siamese mission to Indochina is further evidence of Marshal Phibul's desire to establish friendly relations with the French (page 4).

The policy for the deconcentration of Japanese industry is being considerably revised (page 5).

Soviet tardiness in repatriating Japanese may indicate the discontinuing of repatriation from Siberia and is arousing anxiety in Japan (page 5).

Japanese government action to restrict the right to strike in the electric power industry may develop out of the current labor dispute (page 6).

Important groups in the fledgling National Assembly are pressing for a revision of the governmental structure which will reduce the power of the President and install a responsible cabinet in Korea (page 7).

The government of Chiang Kai-shek was dealt another crushing blow this week in the major curtain raiser of the Communist autumn offensive -- the fall of the city of Tsinan (page 8). The military, political and economic

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SUMMARY (continued)

repercussions following the loss of the Shantung capital will probably be most severe (pages 8, 9, and 10).

A UK bid for Siamese trade has been complicated by Siamese insistence on partial dollar payments (page 11).

The French are giving some consideration to either withdrawal from Indochina or a concentration of French administration in Cochinchina and Cambodia (page 11).

A UN Security Council appeal by the Republic of Indonesia is an imminent possibility (page 11).

Philippine dissidents appear to have been weakened by dissension in ranks and loss of logistical support (page 12).

Declarations of support for the USSR by New Zealand and Australian Communists appear to be an effort to appraise their own present capabilities (page 12).

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SECTION II. DEVELOPMENTS IN SPECIFIED AREAS

GENERAL

Soviet continues trade penetration of Japan

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Continued Soviet interest in trade with Japan is reflected in its offer to purchase three locomotives made in Japan in return for critical raw materials such as coking coal, manganese ore, and pulp. These locomotives had been made during the war for the Fushin coal mines in Manchuria but delivery was not made prior to the termination of the war. The Chinese Government no longer is interested in these locomotives because the Fushin mines are now under (Chinese) Communist control. The locomotives are not of suitable gauge for use either in Japan or Korea, and the USSR appears to be the only market.

This negotiation is a continuation of USSR interest in rolling stock and heavy machinery which are critical items to the Soviet economy.

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The nature of this trade is especially important to Japan because (a) the USSR offers such critical items as coking coal, iron ore, manganese ore, and pulp and (b) Japan hopes to offset post-war competition to its textiles by greater production for export of rolling stock and heavy machinery. Furthermore, as conditions in Southeast Asia continue to deteriorate, and as Communism and Soviet influence spread over Japan's pre-war major trade channels of Manchuria, North China, Korea and Sakhalin, it becomes increasingly evident that Japan will be forced to expand its trade with the USSR as a means of returning to economic normality.

Recent developments regarding a peace treaty for Japan

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Statements regarding the Japanese Peace Conference have, in recent weeks, been numerous and varied. The trend of Chinese statements away from direct attacks on American policy in Japan and toward insistence on an immediate conference for peace with Japan has continued with recurring statements and news stories. Reports that China may conditionally give up her veto power or participate without the USSR at the Japanese Peace Conference are countered by reports that China will on no account waive such right. More recent reports continue to stress that China is prepared to make concessions to bring the Big Four together on an agreement to convene a Japanese peace conference and that Foreign Minister Wang Shih-chieh will make such a move at the UNGA meeting in Paris. Reported concessions which China would be willing to make are on (a) the veto issue, (b) abolition of the emperor system and (c) the Japanese industrial level.

Meanwhile, Soviet press attacks continue exploiting the dissatisfaction of the Far East and South Pacific countries with US policy in Japan.

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GENERAL (continued)

A corollary is to be found in the "fundamental policies of the (Japan) Communist Party regarding peace" made public in the Communist Party's official newspaper, the Akahata. It is believed that hereafter the Japanese communists will undertake a systematic campaign of agitation in favor of the earliest possible peace settlement. It appears likely that this sudden shift in the strategy of the Japan Communist Party is being made with the concurrence, if not under the direction, of the Soviet Union. As the USSR shows no promise of surrendering the often repeated demands for the veto power, it is believed likely that such demands as are made by or through the JCP are designed for maximum propaganda value in support of Soviet objectives including the withdrawal of occupation forces from Japan.

Promotion of friendly Franco-Siamese relations continues

It is increasingly apparent that the present Siamese Government considers a Vietnam-controlled Indochina a greater threat to Siam than a relatively impotent French administration. Siamese and French officials are expanding a working relationship which was initiated after Marshal Phibul returned to power in May 1948. Evidently in return for early French recognition, the Phibul regime has restricted Vietnamese activities in Siam, has dropped the Indochina-Siam border provinces issue and in general has adopted a cooperative attitude toward France. The latest indication of continuing friendly relations is the visit of a Siamese military and friendship mission to Saigon early in September at the invitation of French High Commissioner Bollaert. The announced purposes of the mission were: (a) to promote friendly relations, (b) to cooperate with each other in suppressing robbery and banditry in frontier areas, and (c) to maintain peace and order on the border for mutual benefits. "B"

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KOREA

Important groups in the fledgling National Assembly are pressing for a revision of the governmental structure. Concern over the extensive powers granted the executive in the Constitution, dissatisfaction with President Rhee's appointment of incompetents and alleged pro-Japanese to the cabinet, and the variously-motivated personal desires of influential Assemblymen to exercise closer control of government activities may combine to precipitate a drastic Cabinet shake-up and an amendment to the Constitution introducing a responsible Cabinet and Prime Minister. Leading members of the Hankook Democratic Party, who favor these reforms, agree however, that it would be unwise to create a domestic political crisis until Korea's international status is clarified.

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The development of a responsible cabinet and increased power in the Assembly would lend stability to the Republic in the very likely event of President Rhee's assassination. There is no other single figure in South Korea with sufficient following and popular support to wield successfully the present broad powers of the executive. Rhee's assassination would result in a chaotic struggle for power and a dissipation of the government's popular support. Reducing the President's powers and installing a responsible cabinet would minimize this possibility.

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CHINA

Shantung capital captured by Reds. Tsinan, the capital of Shantung, "A" fell to the Communist forces of CHEN Yi on 24 September. As a consequence of the fall of Tsinan, the Chinese National Government is now entering a new crisis period of unprecedented severity. The Communist armies have launched a coordinated offensive in major areas of operation. Large Red troop movements plus Communist operations against Government forces are evidenced from Hupeh to Manchuria. The National Government is losing its major economic gamble in its fight to curb inflation. The desire for peace via compromise with the Communists will probably grow much stronger in Nationalist China. However, the formation of a Nationalist-Communist coalition would probably require the removal of CHIANG Kai-shek. Although CHIANG's prestige and influence are now at a low ebb, no other leader or group appears prepared or willing, at the moment, to assume power. The capture of Tsinan is significant in that it indicates a change in Chinese Communist North China tactics. Heretofore the Reds have restricted their activities to "hit, ruin, and run" operations against Government lines of communication and supply, and have avoided direct assaults on well-fortified Nationalist cities. The Communist forces now appear ready to pay the price of direct assault against major Government cities and also appear prepared to hold, defend, and administer them. The next major Communist military effort probably will be directed against the major Nationalist military base of Hsuehou.

Military consequences of the fall of Tsinan. The speedy capture of "B" the Shantung provincial capital has released the major concentration of the Communist forces which reduced the city for action against either Tsingtao or, more likely, Hsuehou. At Tsingtao, where the US Navy maintains its Western Pacific anchorage, the possibility of seriously embarrassing the US at a comparatively minor price must be considered. However, it appears more likely that the Communist's main force probably will move south on the major Nationalist military base at Hsuehou. Successful Communist isolation and subsequent reduction of that base with the concurrent annihilation of its defenders would shake the Nationalist regime to its very core. The forces of CHEN Yi, abetted by a strong diversionary effort in the Hankow area by LIU Po-cheng or by his direct participation in the campaign, appear capable of carrying out the envelopment of Hsuehou within several months after launching the effort.

In the Chinhsien area the Communists have, for the first time, thrown elements of their best Manchurian forces into this corridor operation. In the Shansi-Suiyuan-Chahar Border Area and in Central China east of the Peiping-Hankow Railroad, Communist forces are poised but have not yet joined the offensive. Their commitment will increase the weight of the body blows now falling upon the Nationalist Army. The

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defensive capabilities of Government forces are enervated by: 1) depressed morale which tends toward defection, and 2) lack of the trained strategic reserve to reinforce threatened areas without defaulting in another. (Both of these factors played significant roles in the fall of Tsinan). If the Communists can sustain the present tempo of attacks over a period of months, a new series of Communist victories, quickening and growing in importance, can be expected.

The political consequences of the fall of Tsinan and ensuing developments will probably create a more serious crisis for the National Government than any it has yet faced. The morale of the people as well as that of inner government circles will hit a new low as they see the hopelessness of the military and economic situation. CHIANG Kai-shek's power and prestige will decline as a result of his inability to offer any solution. As the position of CHIANG declines, liberal elements and regional leaders within the National Government will become more active in formulating plans for taking matters into their own hands. The cause of the Kuomintang dissidents will also be enhanced. While each new crisis further weakens the National Government, the accumulation of events that may be expected to bring about its collapse is a long process. The assassination of CHIANG by some fanatic would, of course, bring sudden disastrous consequences upon the National Government.

"B"

The USSR may try to take advantage of the plight of the National Government by pushing the idea of Soviet mediation. It is unlikely, however, that such an offer will be accepted until the Generalissimo has withdrawn and the present National Government has in effect collapsed. With the Chinese Communists in their present strong position terms for peace virtually would be terms for surrender of the Nationalists. The Chinese Communists may have considered the capture of Tsinan an essential preliminary to the holding of a Political Consultative Conference, the objective of which is the eventual establishment of a rival government of China. That city may even be the site of this conference. Certain Kuomintang dissidents are reported to have left Hong Kong already for advance consultations on this subject. The capture of Tsinan is an important step in the consolidation of Communist control over North China and thereby strengthens the Communist position in relation to the conference and anticipated coalition government.

Economic consequences of the fall of Tsinan. Although Tsinan lost most of its former economic importance to the Government due to its proximity to military operations during the past three years, the fall of the city may have far reaching effects both on Nationalist and Communist war efforts. Public confidence in the Government's ability to survive, already sorely tried, may reach a new low and will almost certainly be felt severely in the economic sphere. The loss of this strategic military base may seriously affect the already shaky new

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currency, accelerating its depreciation and possibly touching off a worse crisis than that experienced in July and August. On the other hand, Tsinan with its textile mills, arsenal, and railroad shops will substantially increase the meager Communist war potential. The capture of this city also will provide the Communists with a railroad hub, linking sections already operating in eastern and southern Shantung.

National Government may soon be forced to accept Soviet mediation offer. The fall of Tsinan, followed by further Communist military successes and possibly by a sudden collapse of the new currency, may prove to be the coup-de-grace which will force the National Government to accept Soviet mediation in the Civil War. An indication that the USSR may be postponing talks with the Chinese Government in anticipation of further Nationalist disasters which could force the Nationalists to accept mediation is a report that RU Tao-ming, Foreign Office official sent to Moscow for exploratory discussions, has been continuously put off and not received by the Russians. "B"

In view of the possibility of another and more critical economic crisis, resulting in the collapse of the gold yuan, US Embassy Nanking, believes that "the US should immediately throw all available economic resources into an effort to further support the present Government, to which there is no acceptable alternative in sight." The Embassy recommends: 1) using total available LCA China-aid funds for food in anticipation that US Congress may vote additional emergency funds in January, and 2) the US grant an immediate silver loan to maintain the Army, useable in the form of coins and specie as an alternative to valueless paper money. The Embassy states this would apply only for an emergency period of a few months, and is not intended to put China back on the silver standard. "C"

Inflation grows. In spite of severe repressive measures an under-cover, but active, US dollar black market made its first appearance in Shanghai. Shanghai witnessed an unprecedented buying spree last week, indicating a renewed flight from currency to commodities. "C"

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SIAM

UK bid for Siamese trade complicated by Siamese insistence on partial dollar payment. The recent UK invitation to Siam to send a purchasing mission to England to discuss capital equipment requirements for rehabilitation projects, is evidently a strong UK bid to regain her former trade position with Siam. UK trade with Siam has not recovered to pre-war volumes because of the UK's inability to furnish goods as well as the rapidly expanding US-Siam trade. With US dollar demand high in Siam, it is doubtful that the UK will be able to affect markedly the current direction of Siamese trade. For example, Siam is now insisting that the UK pay for fifty percent of her rice purchases in Siam with US dollars. "B"

INDOCHINA

French considering next move. Recent statements to US representatives in Saigon and Paris by the head of the French Surete' in Indochina and by Socialist Minister of National Defense, Paul Ramadier, indicate that some consideration is being given to either complete withdrawal from Indochina or concentration of French administration in Cochinchina and Cambodia. Such a move would be a distinct possibility if the Bao Dai-Xuan solution to the Franco-Vietnamese problem should be abandoned or should fail. In addition, the Surete' head strongly expressed his suspicion that there may be a tie-up between the Xuan Government and Ho Chi Minh's ruling party, the Viet Minh, which apparently accounts for a French decision not to place the internal administration of the French-controlled areas of Vietnam under President Xuan's control for fear of Communist infiltration and eventual control. A similar fear of ultimate Communist supremacy in Vietnam was expressed by Ramadier in Paris when he admitted that to negotiate with Ho, a step recommended by his Socialist Party, would be equivalent to presenting the area to the Communists. However, inasmuch as most French leaders now agree that a military solution is impossible, it would appear that the French will continue a policy of hanging on in Indochina, hoping that a joint US-British solution of the general problem of Communism in the Far East would include support to the French in Indochina. "B"

INDONESIA

UN Security Council appeal by Republic possible. An impending decision by the Netherlands cabinet in regard to the acceptability of the US draft agreement, as well as the outcome of the Communist insurrection in the Republic, may determine the future of UN Good Offices Committee (UNGOC) negotiations in Indonesia. Dutch objections to the US plan are expected to raise fundamental issues which will be difficult for the Republic to resolve in view of its internal crisis. Meanwhile, the Republican Government has formally accepted the US plan as a basis on which to resume UNGOC negotiations. "A"

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INDONESIA (continued)

The Republic has also informed the US Delegation of its intention to enumerate its grievances against the Netherlands in the UN Security Council unless it has assurances before the end of September that negotiations will be resumed on some reasonable basis. The appeal to the Security Council, although it would tend to aggravate existing differences and give rise to prolonged debate in the UN, may be the strongest step which the Republic is capable of taking at present.

PHILIPPINES

Huks may be weakened by dissension and loss of logistical support. "B"
Although no decisive results are expected from the present military offensive against the elusive Huks, the dissidents may be weakened considerably by their inability to secure food and supplies. Developments in the Government's current military operation are cloaked by official silence. However, large-scale evacuations of peasants from troubled areas of central Luzon tend to reduce Huk logistical support. Moreover, recent reports indicate that dissension has arisen in Huk ranks largely as a result of the Government forces' increasing pressure.

In any case, PC-Huk fighting has further disrupted living conditions and has precipitated widespread bloodshed in central Luzon. One provincial governor has requested the Constabulary to assume all police duties in his province. Evacuations from combat zones have been ordered by Government officials. Thousands of families are reported to have fled from the interior to the relative safety of urban centers or to have established temporary living quarters along patrolled highways. Evacuees are said to be weary of the fighting, disillusioned by Huk-Communist leader Taruc's inability to bring peace to central Luzon, and inclined, at least temporarily, to favor the Government's military campaign.

AUSTRALIA and NEW ZEALAND

Communists test public reaction to support for the USSR. Within the "B"
past two weeks prominent Communist Party officials in both Australia and New Zealand have openly declared their support of the USSR in a war involving Australia and New Zealand. Although the Australian statement was later repudiated by the President of the Australian Communist Party, the coincidence of the two statements is significant. The statements appear to be trial balloons sent up by Communist elements in both countries in an effort to appraise their present strength and capabilities.

After some deliberation, the Australian Government has announced that it will file sedition charges against the Communist making the statement. The decision to prosecute is the first legal action taken by the Australian Government against the Communist Party and is in line with the Labor Party policy to deal with Communists, not as a party but individually under the laws of the country. As yet, no action has been announced by the New Zealand Government.